G. Minimize Regulatory Burdens

An access plan should not place unnecessary administrative burdens on customers, carriers or regulators. Such burdens should be viewed as per se unreasonable. Rules and requirements should be easily understandable by all affected entities. The cost of administering any regulatory scheme should be kept to a minimum.

The current access framework, because of its rigidity, has increasingly required an unreasonably extensive and continuing oversight by the Commission. A framework which is more flexible and does not result in frequent rule changes or waivers to accommodate new developments would reduce the cost of regulation for carriers and consumers, and the administrative burden now borne by the Commission.

IV. USTA'S PROPOSAL FOR INTERSTATE ACCESS REFORM

The revisions set out below achieve the goals and objectives discussed in the preceding section. In light of the complexities of the issues involved, a rulemaking proceeding should be opened promptly.

A. Access Services Rate Structure Reform

The specificity of the Part 69 rules now presents a substantial barrier to the introduction of new services and the restructuring of existing services. The current elements codified in Part 69 reflect core service applications defined at least ten years ago (e.g., switched access and special access). As customers' needs have become increasingly complex and sophisticated, these distinctions are less important. Customers are more concerned with the functionality of the service offering, whether it be a single service or an integrated package of separate services.[31]

The access rate structure defined within the rules should be flexible enough to facilitate the introduction of new services and technologies. Such structural flexibility should be achieved by limiting rate structure codification to a list of Public Policy elements for all exchange carriers, as discussed below. Four access categories would be codified for non-price cap exchange carriers.[32] Rate elements would not be codified below the access category level. Also, the current price cap baskets would be restructured consistent with the access categories. New service introduction would be enhanced by reducing filing intervals for new services.

The listing of Public Policy elements, which would be applicable to both price cap and non-price cap exchange carriers, could include: Lifeline Assistance, Universal Service Fund, EUCL Charge, Carrier Common Line (or a substitute recovery mechanism), Long Term Support, Interconnection Charge, Telecommunications Relay Service, Special

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[31]"The AT&T divestiture forced us to get smart. We hired engineers, people who know the technology and what it can do, rather than administrators...As a result, we are pretty sophisticated...We can protect ourselves." as quoted in Haring and Shooshan at p. iii.

[32]An access category is a general classification into which access functionalities are logically grouped.

Access Surcharge and any other elements established by the Commission for explicit interstate public policy purposes.[33]

Common line costs would be recovered through public policy elements. Three of these elements, EUCL, carrier common line and special access surcharge, would be assigned to the Public Policy access category for non-price cap exchange carriers. Only three additional access categories, Switching, Transport and Other, would be utilized. Non-price cap exchange carriers would be able to establish individual rate elements below the access category level on a non-codified basis. Costs would be allocated to all access categories to develop the appropriate revenue requirements, but would not be allocated below the access category level. For price cap carriers, only the EUCL charge element within the Public Policy basket would require cost allocations.

This type of access rate structure would not cause the elimination of any existing services. Existing regulatory processes would remain in place to ensure that services would not be discontinued without appropriate review.[34] This framework would increase exchange carriers' abilities to meet diverse customer requirements. Exchange carriers would be free to propose rate elements for services in tariffs, subject to the

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[33] While the EUCL element would be codified and the revenue target for all common line would be calculated under a specified formula, exchange carriers should be able to propose new rate elements to recover revenues currently recovered through the carrier common line charge.

[34] The Commission has sufficient opportunity to review and approve common carrier proposals to withdraw a service offering. Carriers are required to file tariff modifications for Commission review. Customers have the opportunity for comment in these proceedings.

Commission's approval, but without the need for waivers. Further, it would no longer be necessary for the Commission to classify each proposed new service into one or more of the existing Part 69 access elements – a process which has delayed new service approval in the past.

While some may argue that an individual carrier's freedom to establish rate structures may result in increased complexity to customers, access competitors have been able to introduce a number of additional rate structures with no apparent detrimental effect. Further, freedom to establish rate structures has existed for special access since the access charge plan was adopted. In the interexchange marketplace, the Commission's pro-competitive policies have led to a proliferation of service options from the incumbent carrier, AT&T, as well as from AT&T's interexchange competition. Yet, detailed rules prescribing rate structure, such as those in the current Part 69 rules, have never been applied to interexchange carriers. In the competitive marketplace, the service provider that can innovate and respond in a timely way will be successful. A flexible access structure would enable customers to request and receive offerings that best meet their individual requirements. It would be counterproductive for exchange carriers, particularly in a competitive environment, to develop access service offerings that are undesirable, unnecessarily complex or difficult for customers to understand.

B. Access Services Pricing Reform

The degree of price regulation should respond to the level of competition in a particular market area. The Commission has already established that study area segmentation is permissible and allows exchange carriers to segment study areas into zones comprised of wire centers possessing similar traffic density characteristics.[35] As access markets become increasingly competitive, regulation should reflect that condition. USTA proposes to establish a three tier market structure consisting of Initial Market Areas (IMAs), Transitional Market Areas (TMAs) and Competitive Market Areas (CMAs). Varying levels of oversight and pricing flexibility would be permitted according to the availability of alternative supply and the apparent willingness of customers to utilize it. Prices in IMAs, TMAs and CMAs would be regulated separately. To further respond to customer needs, the current rules should be revised to accommodate these market areas.[36]

1. Market Area Classification

Currently, companies utilize either a zone or study area model for the purpose of establishing a geographic boundary for rates and tariffs. These geographic areas would be renamed IMAs. For those companies which have elected to establish zones, each zone would be designated an IMA. For those companies which have elected not to

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[35] Expanded Interconnection Order at ¶ 179.

[36] These market areas exist to facilitate responsive regulation. There is no suggestion that they constitute markets for antitrust analysis. In fact, USTA strongly asserts that they do not constitute such markets.

zones, each study area would be designated as an IMA. IMAs are the starting point from which exchange carriers may elect to create new market areas.

For each IMA, an exchange carrier would be able to establish a corresponding TMA. A TMA would consist of one or more wire centers from an existing IMA which satisfy the required behavioral criterion signifying emerging competition. A TMA would be subject to reduced regulatory oversight.

The behavioral criterion used to identify those wire centers that may be included in a TMA is the presence of substitutable services from another source. This other source could be a competitive access provider, cable company, cellular carrier, interexchange carrier, private carrier, or microwave carrier within the geographic area served by the wire center. While there are a number of ways exchange carriers could demonstrate the availability of competitive alternatives, the presence of expanded interconnection in a wire center would automatically satisfy this criterion.[37] Because of the cross-elastic nature of access services, all services originating or terminating within these wire centers would be included in the TMA.

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[37]The presence of expanded interconnection is sufficient but not necessary to demonstrate the presence of substitutable services in a wire center. For example, alternative suppliers serve customers without purchasing expanded interconnection. Alternative suppliers also serve customers in the serving area of one wire center by purchasing expanded interconnection in a different wire center.

As each wire center satisfies additional competitive criteria demonstrating more aggressive competition, it may be designated as a CMA. The behavioral criteria used to certify a wire center as a CMA are twofold:

1). That customers within the serving area of the wire center representing at least 25 percent of the demand for the local exchange carrier's interstate access services, or 20 percent of the total market demand for interstate access services within that area, have available to them an alternative source of supply; and,

2). That customers in the serving area of the wire center whose demand represents at least 25 percent of the total demand within that area for the exchange carrier's interstate access services, or a single customer whose demand represents at least 15 percent of that total, actively seek to reduce the cost of their access services through the solicitation of bids, use of private networks, or construction of their own facilities.

By satisfying both criteria for certification as a CMA, the exchange carrier will have demonstrated that the customers in the geographic area served by the wire center have available to them an adequate alternative supply to exert market discipline and have exhibited a willingness to shift their demand to the alternative supply.[38]

Additional criteria are necessary which are sensitive to the unique economic characteristics of specific exchange carriers. The Commission has recognized that in order to achieve the desired effects, regulatory reforms must be "applied with sensitivity to [small and medium sized LECs'] special circumstances."[39] For small and mid-sized

[38]LECs may satisfy the criteria for CMA designation for all access services originating or terminating within a wire center. Optionally, LECs may satisfy the CMA criteria for access services originating or terminating within a wire center for one or more access categories/baskets.

[39]Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd. 6786, 6827 (1990), [Price Cap Order].

LECs, severe financial harm could result from the loss of a single customer. Therefore, USTA proposes that non-Tier 1 exchange carriers may elect to assign a wire center to a TMA or to certify a wire center as a CMA on the basis of "adjacency" or contiguity. In such a case the geographic area served by the wire center must be adjacent to the geographic area served by a Tier 1 exchange carrier wire center that satisfies the applicable behavioral criteria for TMA or CMA certification[40] and the proposed market area classification for the adjacent wire center must be equivalent to that of the Tier 1 exchange carrier wire center that satisfies the applicable behavioral criteria.

2. Price Management

a. Price Cap Basket Design

Under USTA's proposal, the current price cap basket design would be restructured. Rate elements would be grouped for price management purposes into baskets which are based on functionality[41] (i.e., the same basis as discussed above for the access categories proposed for non-price cap exchange carriers). Attachment 3 depicts the proposed price cap basket design.

The revised baskets would allow rates for equivalent functions, such as the current switched transport and special transport, to be grouped in the same basket. These

[40]Unique circumstances may exist such that a non-Tier 1 exchange carrier may need to utilize the adjacency criteria for a wire center not directly contiguous to the wire center satisfying the behavioral criteria. In these rare instances, the non-Tier 1 exchange carrier may file a waiver demonstrating that the competitive environment justifies use of the adjacency criteria in this manner.

[41]The current price cap baskets are grouped according to physical provisioning characteristics which are no longer appropriate.

baskets would also more readily accommodate new services, such as ISDN, configurable private line, or software defined network offerings, which combine functions which would be considered "switched" and "special" under the current structure.

The following baskets are proposed for incorporation in the rules:

<u>Transport</u> - This basket could include:

- All interoffice transport, regardless of whether the transport facility is associated with a switching function;
- All facilities provided under interstate access tariffs between the local serving office and a customer's premises (including current special access channel terminations and entrance facilities between serving wire centers and customers' premises);
- Any features associated with transport, such as line conditioning; and,
- Interconnection Charge.[42]

<u>Switching</u> - This basket could include:

- All current switching functions;
- New switching functions; and,
- Features associated with switching, such as signalling and data base services.

<u>Public Policy</u> - This basket could include:

[42]While the Interconnection Charge is an explicit Public Policy element, it would be price managed within the Transport Basket.

- Special Access Surcharge;
- EUCL Charge; and,
- Carrier Common Line (or substitute recovery mechanism).

Other - This basket could include:

- Any other rate elements which do not fit in the Transport, Switching, or Public Policy baskets.

Within a basket, separate market area categories will be established which correspond to the maximum number of IMAs established in any study area or zone (i.e., IMA1 from each study area or zone would be assigned to market area category IMA1, all IMA2s would be assigned to market area category IMA2, etc.). Separate Digital and Non-digital categories would be established for each IMA within the Transport basket. One TMA market area category will be established for all TMA elements within the Transport, Switching and Other baskets. The Public Policy basket would contain the EUCL, carrier common line and special access surcharge elements for price management purposes. It would not contain IMA and TMA category designations.[43] All other public policy elements would be price managed as they are today. This price cap architecture will provide a safeguard against potential revenue shifting between the IMA and the TMA.

[43]In the future, it may be appropriate to establish market area classifications for public policy elements.

b. Ongoing Price Management

Price changes within both the Public Policy basket and Public Policy access category would be subject to rules established specifically for each element. Price changes within IMAs and TMAs would continue to be subject to existing regulation, with increased pricing flexibility for the TMA. The price cap indices and bands will restrain the potential ability of price cap carriers to increase IMA prices to offset declines in TMA prices. Non-price cap carriers would be granted pricing flexibility with the safeguards described below.

For those carriers under price cap regulation, price cap indices would be established for each of the aforementioned baskets. Consistent with current price cap regulation, the basket API could not exceed the basket PCI. Individual IMA and TMA categories would have an upper limit of 5 percent for changes in the basket PCI. The lower limit for IMA categories would be 10 percent while the lower limit for TMA categories would be 15 percent. An exchange carrier may file below-band rates by providing supporting materials demonstrating that the rates cover average variable cost or that the additional net revenue exceeds additional costs. Prices may be adjusted either upward or downward to the extent that they comply with all applicable pricing safeguards and rules.

Non-price cap carriers under optional incentive regulation[44] would be allowed to increase or decrease aggregate prices in a market area category by 10 percent in an IMA access category and increase aggregate prices by 10 percent or decrease such prices by 20 percent in a TMA access category on a biennial basis. Those non-price cap carriers which do not elect optional regulation may choose one of two methods for price management. First, these carriers may use the same structure as exchange carriers under optional incentive regulation. However, prices could only increase or decrease by 5 percent in an IMA and increase by 5 percent or decrease by 10 percent in a TMA. In the alternative, these carriers may increase individual rate elements by 5 percent per year and to decrease individual rate elements without limit. Price changes could not cause total revenue for an access category to exceed the revenue requirement for that category used in the most recent annual or biennial filing, evaluated at the demand used in that filing. The results of these rate changes should be cummulative, in that the rate relationships at the end of the tariff period should be used to set rates at the beginning of the next tariff period.[45] Attachment 4 depicts the proposed access category structure and price management guidelines for non-price cap exchange carriers under optional incentive regulation and Attachment 5 depicts the proposed structure for other non-price cap carriers.

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[44] Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135, Report and Order, released June 11, 1993.

[45] Id. at ¶ 39.

When service components extend across multiple market areas, the applicable price will be the lower of the prices that prevail in each of the two market areas in which the two endpoints for each service component are located.

Once a TMA has been established, price cap and non-price cap exchange carriers would be able to respond to a request for proposal from a customer with a contract tailored to meet the customer's needs.[46] Rates for services in a CMA would be outside of the access rules. Market constraints would fully replace price caps as the control mechanism to ensure reasonable rates in competitive market areas. However, these CMA services would continue to be regulated as Title II communications services, so long as such regulation is required by the Act.[47] Contract-based tariffs would be permitted for any service included in a CMA. The demand and price associated with TMA contracts would not be included in the price cap index calculations for establishing prices. Likewise, for non-price cap carriers, the revenue and cost associated with TMA and CMA contracts would not be included in revenue requirement calculations for establishing prices. This is consistent with the evolving rules in other comparable areas.[48]

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[46] See, AT&T Communications Revisions to Tariff F.C.C. No. 12, CC Docket No. 87-568, Memorandum Opinion and Order, 4 FCC Rcd 4932 (1989); recon. denied, 4 FCC Rcd 7928 (1989); rev'd and remanded sub nom. MCI v. FCC, 917 F.2d 30 (D.C. Cir. 1990); on remand, 6 FCC Rcd 7039 (1991). (Customer-specific arrangements are acceptable if available to be provided to any others).

[47] Current Title II requirements include tariff filings for CMA services and provide customers with potential regulatory relief through the complaint process.

[48] See, Competition in the Interexchange Marketplace, CC Doocket No. 90-132, Report and Order, 6 FCC Rcd 5880 (1991).

3. Filing Requirements

a. Notice Intervals for Filings

In-band pricing changes would continue to be filed on 14 days' notice by all exchange carriers. Above band changes would be filed on 120 days' notice and below band changes would require 45 days' notice. Annual and biennial filings would be filed on 90 days' notice. Filings which restructure existing services would be filed on 21 days' notice. New services and non-price cap service filings would require 45 days' notice in an IMA, 21 days' notice in a TMA and 14 days' notice in a CMA. Contract-based services would be filed on 21 days' notice in a TMA and 14 days' notice in a CMA. All other filings, including filings establishing prices for market areas and segments, would be filed with a notice period of 21 days.

b. Technical Publications

Carriers typically do not burden their tariffs with the technical details associated with their services. To promote wider disclosure of important network assumptions, the current requirement for waivers of Part 61.74 of the rules should be eliminated.

c. Cost and Demand Support

Attachment 6 outlines the cost and demand support requirements for various filings which affect rates and charges for price cap and non-price cap exchange carriers.

C. Elimination of Sharing for Price Cap Carriers

The sharing mechanism adopted by the Commission for price cap carriers is out of place in the current environment. If the Commission intends to continue to pursue procompetitive policies, restrictions on earnings must be eliminated. As markets are more competitive, the need for regulatory oversight will decrease. Recognizing that this process will develop at different rates in different markets, USTA's proposal establishes a framework which adjusts the degree of regulation to match the degree of competition in each market area. A pure price cap approach, without sharing, will allow the Commission to protect consumers effectively in less competitive areas (IMAs), while relaxing regulation in more competitive areas (CMAs). Because there will be no link between the performance of exchange carriers' services in CMAs and the cap on IMA and TMA services, the protection afforded customers in less competitive markets will not be affected by decisions the exchange carrier makes with regard to its CMA services. Further, this protection will be maintained without the need to allocate costs among interstate access services.[49]

USTA's proposal, by eliminating the sharing mechanism, severs the link between the cap on prices in less competitive areas and the performance of services in more competitive areas. It allows the Commission to relax regulation where competition is stronger, while maintaining protection for consumers in areas where competition is less

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[49]As exchange carriers' networks incorporate new technology and provide a wider array of services on an integrated basis, cost allocation will become even more difficult and less meaningful.

well developed–protection which is more effective than any that would be possible through a sharing mechanism.

Rate of return represcription and sharing mechanisms in a price cap environment conflict with the Commission's goals, as well as the objectives of access reform, and should be eliminated. Since price cap carriers are no longer subject to rate of return regulation, the rate of return represciption process should be eliminated.[50] Accordingly, an exchange carrier's ability to invoke the adjustment mechanism which allows exchange carriers to automatically recover revenue shortfalls for those periods where revenues do not achieve a minimum rate of return should be eliminated. Exchange carriers could continue to file tariffs proposing rate changes when earnings are below an acceptable level. In those instances where the proposed rate changes exceed the price cap index, the exchange carrier could demonstrate the reasonableness of the proposed rate changes. Filings of this nature would not result in the price cap carrier again becoming subject to extensive cost support requirements.[51]

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[50]This is in concert with the Commission's tentative conclusion regarding rate of retrun represcription in its Notice of Proposed Rulemaking and Report and Order in CC Docket No. 92-133, Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes. In paragraph 14, the Commission states that AT&T and all of the BOCs were removed from rate of return regulation. In paragraph 90, the Commission finds that since removing AT&T from rate of return regulation, the rules concerning represcription are superfluous and should be eliminated. USTA believes that similar treatment would be appropriate for price cap exchange carriers.

[51]As the Commission recognized in the price cap proceedings, additional consideration, especially for elective price cap carriers, may be necessary to address the potential for severe underearnings situations which could harm customers, as well as stockholders.

Sharing is not required to ensure that rates are just and reasonable. Price cap rates were initialized from rates lawfully established under rate of return regulation. The price cap index adjusts to account for changes in inflation and productivity. In addition, the consumer productivity dividend provides additional benefits to consumers. If earnings levels for a particular price cap carrier increase because of efficiency improvements, that does not mean that the carrier's rates are unjust or unreasonable. Under price cap regulation, there is no link between earnings and the reasonableness of rates. Nor is such a link necessary. Section 208 of the Communications Act provides a mechanism for resolution of complaints regarding rates. Thus, appropriate mechanisms are already in place to assure that exchange carrier rates are just and reasonable. The Commission need not and should not rely on the sharing mechanism to accomplish this task.

Although the Commission has recognized that pricing flexibility for new services can strengthen carrier incentives to innovate, the earnings restraints imposed by sharing substantially eliminate these incentives because they reduce the potential rewards for undertaking risky and potentially costly innovation. While the development of a new service often entails considerable research and development costs, a substantial amount of uncertainty regarding a great number of factors accompanies that development. Questions arise such as: Will there be unexpected snags that will lead to higher than anticipated actual production costs? Will there be sufficient demand for this product? Can the product be developed within the "window of opportunity" time frame? Will the new product be as reliable when implemented as it was under testing? These questions often cannot be answered until after the costs to develop the service have been incurred. The more innovative the new service is, and the more it relies on unproven technology and uncharted markets, the greater the risk of falling short of product expectations or product failure. Sharing is inconsistent with the access reform objective to promote the introduction of new services and technologies because it does not recognize the risk involved in introducing a new service.

Sharing also reduces incentives for carriers to become more efficient. It makes little sense to undertake the effort required to reengineer work processes if the fruits of the labor will not be retained by the carrier. If an exchange carrier can become more efficient, there is no reason why that carrier should not be able to retain the earnings derived from this increased efficiency. Sharing penalizes exchange carriers which have the potential to realize benefits from efficiency gains and thus significantly reduces economic incentives to engage in process improvement, a basic tenet of incentive regulation.

Sharing is incompatible with the public interest objectives of access reform. The public interest will not be fully served, even if the other aspects of the access reform proposal discussed herein are adopted, unless sharing is eliminated.

D. Public Policy Support Obligations

Historically, regulators have relied upon the traditional goal of "universal service at reasonable prices" as a guidepost when crafting many of their public policy decisions. This goal is consistent with the statutory requirement "to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, ..."[52] In order to accomplish this traditional goal, regulators established policies such as geographically averaged prices[53] and "obligation to serve" requirements.

In addition, regulators implemented a number of support mechanisms to recover the costs of ubiquitously deployed services. In effect, regulators determined that the public interest benefits of full connection to the telephone network exceeded any risks of monopoly provision of service, particularly where natural monopoly characteristics prevailed and prices did not have to be premised solely on economic cost recovery principles. Technology and competitive policies responsive to technology have changed those assumptions. Technological advances have significantly eroded any natural monopoly characteristics of the local exchange marketplace, by reducing unit costs and

[52]47 U.S.C. 151

[53]Interestingly enough, the Commission's task force realized the potential problems of such a requirement. They found that "averaged rates can mean that in low cost areas, LEC rates are too high, creating a pricing umbrella that allows the CAPs to price just below the LECs even if [the LECs'] costs would permit a lower rate . . . Conversely, in higher cost areas, the LECs' rates might be too low, making it unlikely that CAPs would enter that market. Consequently, the benefits associated with competition may not be fully realized and the goal of fostering an efficient local exchange network may be compromised." Staff Analysis at p. 47.

barriers to entry even without a wide subscriber base. Declining, forward-looking average costs are no longer solely a result of economies of scale, which still exist, but which now reflect the lower costs of newer technologies.

Both Federal and state regulators have initiated policies designed to facilitate competitive entry into access service markets. Competitive entry results in the erosion of exchange carrier demand and forces exchange carriers to establish prices more reflective of marketplace conditions and the cost of providing service. As competition erodes the contribution currently inherent in exchange carrier rates, exchange carriers are faced with few, if any, choices for recovery of costs. In addition, capital recovery policies have not kept pace with technological innovation and with the competitive provision of service. The Commission's procompetitive access policies are at odds with traditional universal service and related public policy goals. To solve this dilemma, regulators must, at a minimum, review current support mechanisms to ensure their continued viability and explore the need for additional, or competitively neutral, explicit support mechanisms to replace those which are implicit in current access service prices. The following sections offer recommendations on existing support processes as well as new mechanisms designed to provide for continued public policy support in a competitive environment.

1. Modifications to Explicit Support Mechanisms

Regulators have implemented various cost recovery support mechanisms designed to offset some high cost aspects of providing universal service. These existing support mechanisms have been designed to recover specific, targeted costs and serve as stand-alone, explicit cost recovery mechanisms.

USTA believes that the current explicit universal service support mechanisms are viable support measures and must be maintained. However, all market participants should be required to share the recovery of universal service support costs.[54] Assigning these costs to only one provider in a market arbitrarily disadvantages that provider and its customers. Sharing such costs on a competitively neutral basis will permit the recovery of universal service costs without the threat of unjustified and uneconomic losses as competition continues to grow and prices are driven closer to incremental costs. USTA's proposal, with the limited funding changes, follows:

Universal Service Fund (provides assistance to exchange carriers with loop costs exceeding 115 percent of the nationwide average)

- No change in qualification procedures because Fund is properly targeted to support universal service. Cost recovery should be expanded to include all market participants.

Linkup (assists qualified subscribers with the payment of telephone service establishment charges)

[54]"...the LECs' rates for various access services may reflect certain regulatorily mandated support mechanisms designed to achieve social policy objectives. In a competitive environment, we believe that all market participants must be required to share the cost of such support mechanisms". Expanded Interconnection Order at ¶ 145.

- No change in qualification procedures as it is properly targeted at end users. Cost recovery should be expanded to include all market participants.

<u>Lifeline</u> (assists qualified subscribers by reducing EUCL charges)

- No change in qualification procedures as it is properly targeted at end users. Cost recovery should be expanded to include all market participants.

<u>Long Term Support</u> (keeps pooling exchange carriers' carrier common line rates close to the nationwide average)

- No change in qualification procedures but optional cost recovery mechanisms should be considered including the option for exchange carriers to bulk bill to interexchange carriers.

<u>Carrier Common Line Charges</u> (recover common line costs from interexchange carriers)

- Economic alternatives to the charge should be considered. (A surrogate carrier common line rate could still be calculated and reported to NECA for development of Long Term Support funding amounts). This could include recovery through flat rate elements.

2. Modifications to Implicit Support Mechanisms

New support mechanisms may be required to ensure that the Commission's universal service goal can be maintained in spite of its decision to accelerate the development of competition for access services. Universal service should not be disadvantaged by the results of the Commission's procompetitive policies.

The Commission's task force found that the "emergence of competition in interstate access makes it difficult to sustain the existing contribution and assistance mechanisms that have been part of the Commission's regulatory policies. The resulting distortions in access pricing make it difficult for exchange carriers to compete effectively, particularly since competitors' rates are not similarly burdened with such regulatory distortions."[55]

There are implicit support flows embedded in the current access price structure. For example, there are two types of intracompany contribution flows embodied in interstate switched access rates. Each is a product of the Commission's separations and Part 69 rules. The first is a contribution flow from high volume/lower cost to low volume/higher cost areas which is a product of the required application of average rates to a service (e.g., carrier access). The second is an interservice contribution flow, which involves services in both the interstate and intrastate jurisdictions.

a. High Volume to Low Volume Contribution Flow

Exchange carriers incur substantial costs to provide ubiquitous connectivity between all points on the telecommunications network as a result of requirements imposed on them to serve all customers and to operate as the carriers of last resort. These requirements have resulted, and will continue to result, in exchange carriers making substantial investments in rural or high cost areas. The recovery of these costs poses significant problems for exchange carriers since there are vast usage differences between rural and metropolitan areas. In rural areas, fixed costs typically must be

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[55] Staff Analysis at p. 53.

recovered from smaller service volumes which result in a higher cost per unit. One implicit support mechanism which assists in the recovery of rural and high cost network connectivity is geographically averaged access pricing. Prices for low cost, high usage areas are presently the same as areas with high costs and low usage.

Within a competitive environment, price disparities between high cost and low cost areas will naturally result. If the Commission continues to believe that contribution flows are necessary to mitigate access service price disparities, an additional intra-company universal service support mechanism could be identified, measured and implemented. This mechanism would be used to replace the implicit support flows inherent in average pricing. If the Commission determines that a new support mechanism is needed, it should be designed and targeted to ensure no overlap with other support mechanisms. This type of mechanism should be optional, explicitly identified and company specific. Furthermore, this mechanism must be funded by all service providers based on criteria not associated with exchange carrier services.

b. Interservice Contribution

The Commission's procedures for determining interstate carrier access rates, which were developed to support universal service concepts in a less competitive environment, likely resulted in inappropriate cost allocations to the interstate jurisdiction in general and to switched access (i.e., traffic sensitive). To assess whether and to what extent this is true, USTA commissioned a study using Long Run Incremental Cost.[56] This study found that there is a contribution of approximately $20 billion annually in the rates that exchange carriers charge to interexchange carriers for switched access and intraLATA toll service.[57] To determine what service categories received this contribution flow, USTA also commissioned an analysis using existing data and studies which compared revenues for exchange carrier services with embedded direct revenues.[58] The results of this analysis demonstrated that there are significant interservice support flows from switched access and state toll services to the residence customer access service.

USTA's proposal would better enable exchange carriers to price manage the contribution to residence services in the face of increased competition. The Commission should take appropriate, concurrent action to deal with this issue on a long term basis.

c. <u>Capital Recovery</u>

[56]C. Monson and J. Rohlfs, The $20 Billion Impact of Local Competition in Telecommunications (July 16, 1993).

[57]Other filings in related dockets have identified that exchange carrier switched access prices are currently well above their marginal costs and therefore provide contribution to other services. See, for example, Comments of the Staff of Bureau of Economics of the Federal Trade Commission in CC Docket No. 91-141 filed March 5, 1993, Reply Comments of Pacific Bell and Nevada Bell, filed on March 19, 1993 in CC Docket No. 91-213, at Exhibit A, Reply Comments of the NYNEX Telephone Companies, filed on March 19, 1993 in CC Docket No. 91-213, at Exhibit A and Ex Parte filing of the NYNEX Telephone Companies, filed on July 14, 1993 in CC Docket No. 91-213.

[58]Letter of F.W. Nolte, Executive Director, Access and Separations Support, Bellcore, to R. O. Calkins, Vice President - Policy Development, USTA, July 19, 1993 attached to Monson-Rolfs study.